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GASB 68

Overview with Implementation and Audit Perspectives

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Agenda.

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- Effective Date and Transition.
- Summary of Financial Reporting Improvements.
- Types of Employer Pension Plans.
- Summary of Pension Standard Changes.
- Accounting and Financial Reporting Overview.
- Implementation Issues.

Effective Date and Transition.

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- Effective for fiscal years beginning after June 15, 2014 (i.e., FY 2014/15 for most)
- Employers would be required to **restate** prior year financial statements under the new rules, if practical
  - If restating beginning deferred outflows and inflows is not practical, start with a zero beginning balance
  - If restatement of all prior periods is not practical, cumulative effect of applying GASB 68 to beginning balances
- For 10 year trend information in Required Supplementary Information… all 10 years may not be readily available. During the transition period, present as many years as are available

Summary of Financial Reporting Improvements.

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- The Statement improves the decision-usefulness of information in employer financial reports and will enhance its value for assessing accountability and inter-period equity by requiring the following:
  - Recognition of the entire net pension liability
  - A more comprehensive measure of pension expense
  - More robust disclosures of assumptions that will allow for better informed assessments of the reasonableness of pension measurements

Summary of Financial Reporting Improvements.

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(continued)

- Explanations of how and why the net pension liability changed from year to year (improve transparency)
- The summary net pension liability information, including ratios, will offer an up-to-date indication of the extent to which the total pension liability is covered by resources held by the plan
- The incorporation into benefit projections of ad hoc COLAs or other benefit changes that are substantively automatic

Summary of Financial Reporting Improvements.

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(continued)

- The use of a discount rate that considers the availability of plan resources associated with the pension benefits of current and former employees and the investment horizon of those resources
- A single method of attributing the actuarial present value of projected benefit payments to periods of employee service
- Immediate recognition in pension expense of effects of plan benefit changes, also shorter amortization periods for the effects of:
    - Changes in actuarial assumptions
    - Actuarial gains and losses
    - Difference between actual and projected investment earnings

Types of Employer Pension Plans.

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- Single-employer pension plans involve only one (1) government
- Agent multiple-employer pension plans
  - Separate accounts are maintained for each government in the plan
  - Akin to a collection of single-employer pension plans
- Cost-sharing multiple-employer pension plans
  - Governments share costs and risks
  - Any assets in plan may be used to pay any employee's benefits regardless of sponsoring government

Summary of Pension Standard Changes.

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Single and Agent Multiple-Employer Plans

	Current Accounting Standards (GASB 27)	New Accounting Standards (GASB 68)	Impact of New Standards
Pension Liability – recognized in plan sponsor's financial statements	Net Pension Obligation (NPO) – Measured as the cumulative difference between the employer's annual required contribution (ARC) and actual contributions	Net Pension Liability (NPL) – Measured as the difference between the employer's total pension liability (TPL) and the plan's fiduciary net position as of the measurement date	Inclusion of NPL on employer's statement of net position will result in major change in financial reporting. The NPL will be more volatile than the current unfunded actuarial accrued liability (UAAL).

Summary of Pension Standard Changes.

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	Current Accounting Standards (GASB 27)	New Accounting Standards (GASB 68)	Impact of New Standards
Pension Expense – recognized in plan sponsor's financial statements	Annual Pension Cost (APC) Measured as employer's ARC plus certain adjustments. ARC = normal cost + amortization of UAAL	Pension Expense (PE) – Measured as the change in NPL with certain exceptions. <u>Immediate recognition</u>: • Service cost (+) • Interest on TPL (+) • Changes in benefits (+or-) • Administrative expenses (+) <u>Deferred recognition</u>: • Changes in TPL due to changes in actuarial assumptions and differences in assumed and actual actuarial experience • Changes in Assets due to difference between projected and actual investment returns	New measurement will disconnect the relationship of funding to expense recognition The direct relationship to the change in NPL with shorter deferral and recognition periods will increase the volatility in the new pension expense

Summary of Pension Standard Changes.

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	Current Accounting Standards (GASB 27)	New Accounting Standards (GASB 68)	Impact of New Standards
Deferred Inflows and Outflows	Not recognized	• Changes in TPL due to changes in actuarial assumptions and differences in assumed and actual actuarial experience. Amortized over remaining service period of all employees (active and inactive) • Changes in Assets due to difference between projected and actual investment returns. Amortized over 5 years	Deferrals will provide some degree of "smoothing" of market volatility and changes in economic or demographic factors

Summary of Pension Standard Changes.

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	Current Accounting Standards (GASB 27)	New Accounting Standards (GASB 68)	Impact of New Standards
Discount Rate	Long-term investment rate of return	"Blended" discount rate is used to the extent that projected benefits exceed projected assets	A blended discount rate will likely be lower than the long-term investment rate of return resulting in a larger TPL
Attribution Methodology	One of six allowed methodologies can be used	Entry age actuarial cost method	Use of one actuarial cost method will provide uniformity in the calculation of TPL and current service cost.
Asset Valuation	Generally smoothed market value	Fair value of Plan's investments included in net position	Use of fair value will add volatility to the NPL and PE

Summary of Pension Standard Changes.

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Cost- Sharing Employer Plans

	Current Accounting Standards (GASB 27)	New Accounting Standards (GASB 68)	Impact of New Standards
Pension Liability – recognized in plan sponsor's financial statements	Pension Liability – Measured as the cumulative difference between the employer's contractually required contributions and the actual contributions.	Pension Liability – Measured as the employer's "proportionate" share of the cost-sharing plan's collective net pension liability.	Inclusion of NPL on employer's statement of net position will result in major change in financial reporting. The NPL will be more volatile than the current unfunded actuarial accrued liability (UAAL).
Pension Expense – recognized in plan sponsor's financial statements	Contractually Required Contribution – Measured as the employer's contractually required contribution to the cost-sharing plan.	Pension Expense – Measured as the employer's "proportionate" share of the cost-sharing plan's collective pension expense.	New measurement will disconnect the relationship of funding to expense recognition. The direct relationship to the change in NPL with shorter deferral and recognition periods will increase the volatility in the new pension expense.

Accounting and Financial Reporting Overview.

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- Requires employers to recognize:
  - Net pension liability (NPL)
  - New measure of pension expense
  - Deferred outflows and inflows of financial resources
- Expanded note disclosures reflecting "new" measurement of NPL, pension expense and deferred outflows and inflows
- Supplementary information reflecting "new" accounting measurements

Single and Agent Employers

The Net Pension Liability (NPL)

- Unfunded pension obligation a government (employer) is responsible to pay
- Equals *Total Pension Liability* less *Plan Net Position* (primarily investments reported at fair value)
- Replaces current cumulative difference between annual pension cost and contributions made (the Net Pension Obligation or NPO)
- Reported on the face of a government's financial statements and would substantially increase the liabilities reported for most governments

Measuring the Total Pension Liability involves:

- Projecting future benefit payments
- Discounting projected future benefits to present value.
- Allocating present value of projected future benefits to past and future periods

Projecting Future Benefit Payments

- Continue past practice of incorporating expectations of future employment related events into projections
- Includes valuation of ad hoc COLAs or other benefit changes that occur regularly and are substantively automatic (New)

Discounting Future Benefit Payments to Present Value

- Previous standard's discount rate = Expected future rate of return on pension plan's investments over the long-term
- New standard largely keeps status quo except when assets are not expected to meet future plan benefits
  - Difference would be discounted by a 20-year high-quality tax-exempt general obligation municipal bond index rate (AA/Aa or higher)
- New standard will likely result in a lower blended discount rate for plans that are significantly underfunded, thus, increasing the total pension liability

Crossover/Depletion Test.

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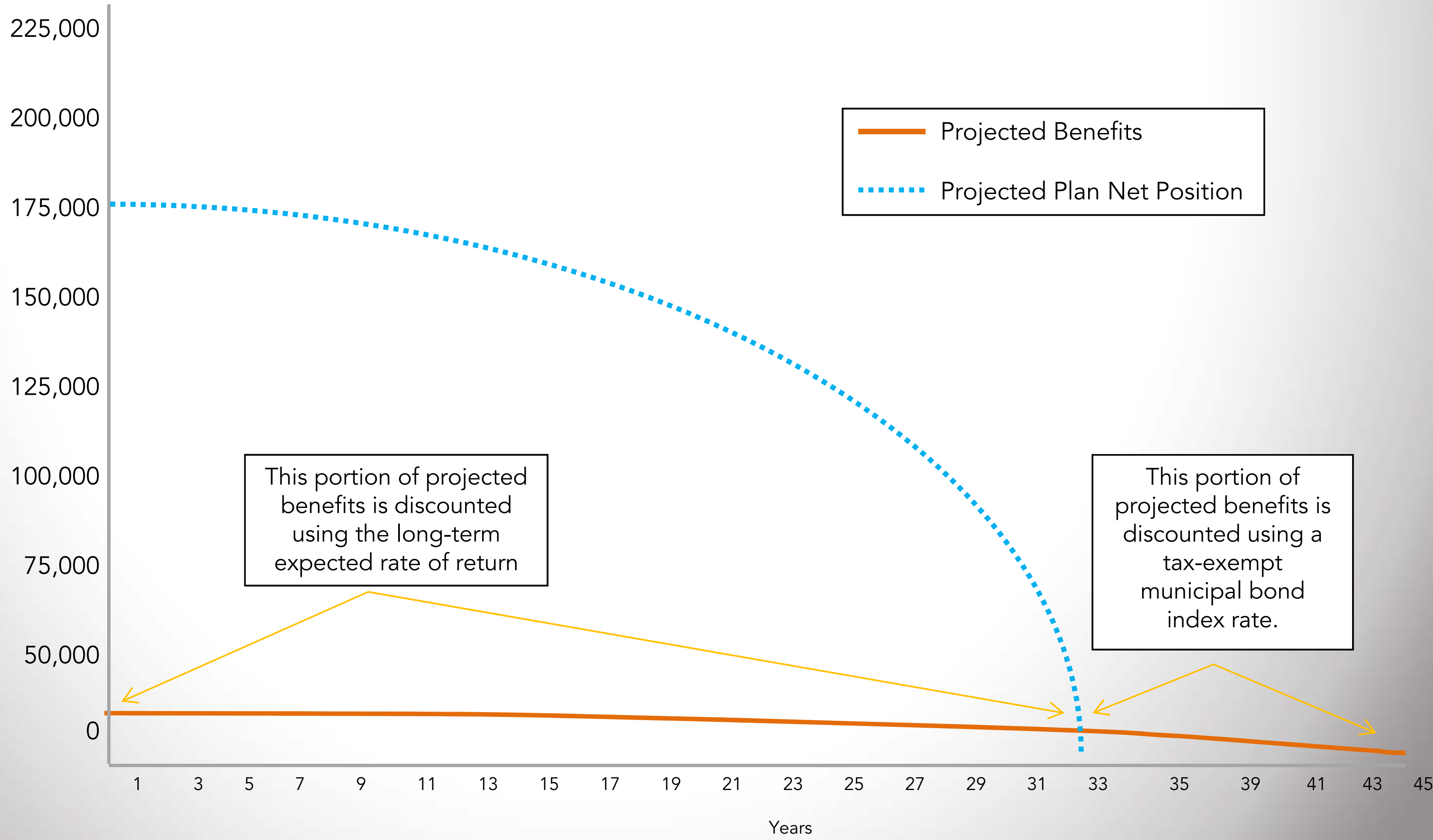

Allocating Present Value of Projected Benefits

- Previous standard allows for 6 actuarial cost methods to select from and allows attribution of payments to be done either in level dollar amounts or as a level percentage of payroll
- New standard only allows for the Entry Age (EA) Method
  - EA is based on an individual calculation for each active plan member
  - Allocated at a level percentage of payroll

Accounting and Financial Reporting Overview.

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	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a) – (b)
Balances at 6/30/X8	$ 2,853,455	$ 2,052,589	$ 800,866
Changes for the year:			
Service cost	75,864		75,864
Interest	216,515		216,515
Differences between expected and actual experience	(37,539)		(37,539)
Contributions—employer		79,713	(79,713)
Contributions—employee		31,451	(31,451)
Net investment income		196,154	(196,154)
Benefit payments, including refunds of employee contributions	(119,434)	(119,434)	-
Administrative expense		(3,373)	3,373
Other changes		8	(8)
Net changes	135,406	184,519	(49,113)
Balances at 6/30/X9	$ 2,988,861	$ 2,237,108	$ 751,753

Timing and Frequency Considerations of NPL

- Measured as of a date no earlier than the employer's prior fiscal year-end (the measurement date)
- Measurement of NPL can be from:
  - Actuarial valuation as of the measurement date
  - Update – procedures rolling forward amounts from an actuarial valuation as of a date no more than 30 months plus 1 day prior to the employer's most recent fiscal year-end
- Actuarial valuation at least biennially
- Must reflect significant changes from the actuarial valuation date up to the measurement date

Recognition of Pension Expense

- Objective is to recognize expense as employees earn their pension benefits rather than when benefits are funded

- Changes in the net pension liability should be recognized in pension expense except as follows:
  - Difference between expected and actual actuarial experience
  - Changes in actuarial assumptions
  - Difference between expected and actual investment earnings
  - Employer contributions

Deferred Outflows and Inflows

- Certain components of NPL are deferred as Outflows or Inflows of financial resources
  - Changes in actuarial assumptions (TPL)
  - Actuarial gains and losses (TPL)
  - Difference between actual and projected investment earnings (PNP)

Cost-Sharing Multiple-Employer Pension Plans

- Current requirements:
  - Reflect the sharing of risks and assets
  - Does not require actuarial information to be presented for individual employers
  - Information found in the cost-sharing pension plan's own financial statements
- Proposed requirements:
  - Report the government's proportionate share of net pension liability
  - Report the government's proportionate share of annual pension expense

Notes to the Financial Statements
All Governments

- Pension Plan Description
  - Name of plan
  - Identification of PERS or other administrator
  - Identification of the type of plan
  - Benefit terms
  - Plan membership
  - Contribution requirements
  - Pension plan reporting and how to obtain it

Accounting and Financial Reporting Overview.

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(continued)

- Assumptions and Other Inputs
  - Inflation
  - Salary changes
  - Ad-hoc benefit changes, including COLAS
  - Mortality and sources
  - Dates of experience studies
  - Discount rate
    - Rate applied and changes from last measurement date
    - Assumptions made about projected cash flows
    - Long-term rate of return and how derived
    - Municipal bond rate and source (if applicable)
    - Projection period for long-term and municipal rate
    - Assumed asset allocation and long-term rate by class
  - Sensitivity analysis for NPL (±1%)
- Pension Plan's Fiduciary Net Position

Notes to the Financial Statements
Single and Agent Employers

- Changes in NPL
- Measurement date of NPL
- Date of actuarial valuation used in NPL calculation
- Description of changes in assumptions and other inputs
- Description of changes in benefit terms
- Amount of pension expense recognized by employer
- Balance of deferred outflows and inflows related to pensions
- Schedule of amortization of deferred outflows/inflows for next five (5) years and total thereafter

Notes to the Financial Statements
Cost-Sharing Employers

- Employer's proportionate share (percentage), basis for proportionate share and changes in proportionate share since the prior measurement date
- Measurement date of collective NPL
- Date of actuarial valuation used in collective NPL calculation
- Description of changes in assumptions and other inputs
- Description of changes in benefit terms
- Amount of pension expense recognized by employer
- Balance of deferred outflows and inflows related to pensions
- Schedule of amortization of deferred outflows/inflows for next five (5) years and total thereafter

Required Supplementary Information – *Single and Agent Employers*

- 10 year schedule of changes in NPL
- 10 year schedule of TPL, plan's fiduciary net position, NPL, covered-employee payroll, etc.
- 10 year schedule of actuarially determined contributions (if applicable)
- 10 year schedule of statutorily or contractually established contributions (if applicable)
- Notes to required supplementary information

Required Supplementary Information – *Cost-Sharing Employers*

- 10 year schedule of proportion of collective NPL, proportionate share of NPL, covered-employee payroll, etc.
- 10 year schedule of statutorily or contractually established employer contributions
- Notes to required supplementary information

Measurement Date

- What is being "measured" … Net Pension Liability (NPL)
  - Based on the actuarial present value of projected benefit payments (total pension liability)
    - Actuarial valuation or update (roll forward) at measurement date
  - Net of the Plan's fiduciary net position (i.e, net value of assets held in trust to pay pension benefits)
  - NPL: Should be measured as of a date no earlier than the end of the employer's prior fiscal year, consistently applied from period to period

Measurement Date, continued

- What is the best, most consistent date an employer should use?
  - Within one year of the current fiscal year-end
    - As of current fiscal year-end:
      - Plan needs to get through audit and actuarial valuation before employer closes its books!
      - Can the employer receive this information timely, year after year?
    - As of prior fiscal year-end – most likely
  - Different reporting dates … e.g., Employer has 6-30 year-end, while Plan has 12-31 year-end

Actuarial Methods and Assumptions

- What kind of discussions should be held between Employer and Plan?
  - Pension funding policy
  - Methods and assumptions must always comply with Actuarial Standards of Practice
    - Discount rate – evaluate the "run out" calculation as soon as possible
  - Employer has primary responsibility for fair presentation of pension data in its financial statements
    - Use of a management specialist

Actuarial Methods and Assumptions

- What kind of discussions should be held between Employer and Plan? (continued)
  - Determination of proportionate share of total employer contributions for cost-sharing plans
  - If update procedures are used (roll forward), significant changes between actuarial valuation date and measurement date must be evaluated

Accounting and Reporting Matters

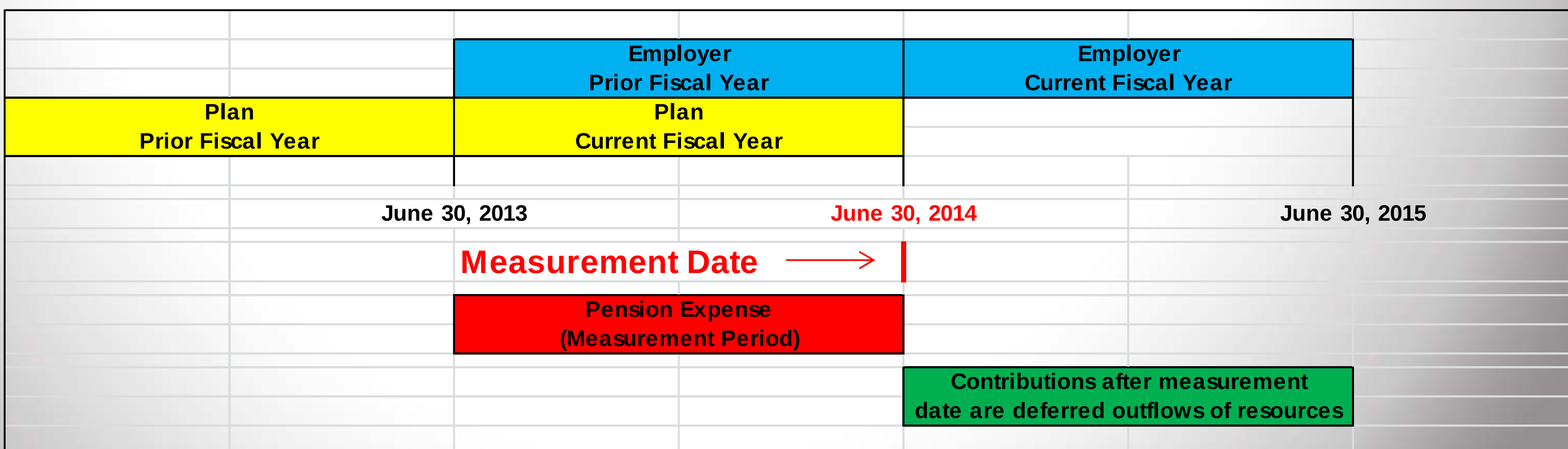
- Employer reporting for pensions on the statement of resource flows (a.k.a., income statement)

  - Governmental funds report pension expenditures based on contributions made during the period

  - Government-wide and proprietary funds report the cost of pension benefits as pension expense (i.e., must replace the pension contributions with the new pension accounting)

Accounting and Reporting Matters

- The accounting impact of a "Measurement Date" that is one year earlier than the financial reporting date:



Implementation Issues.

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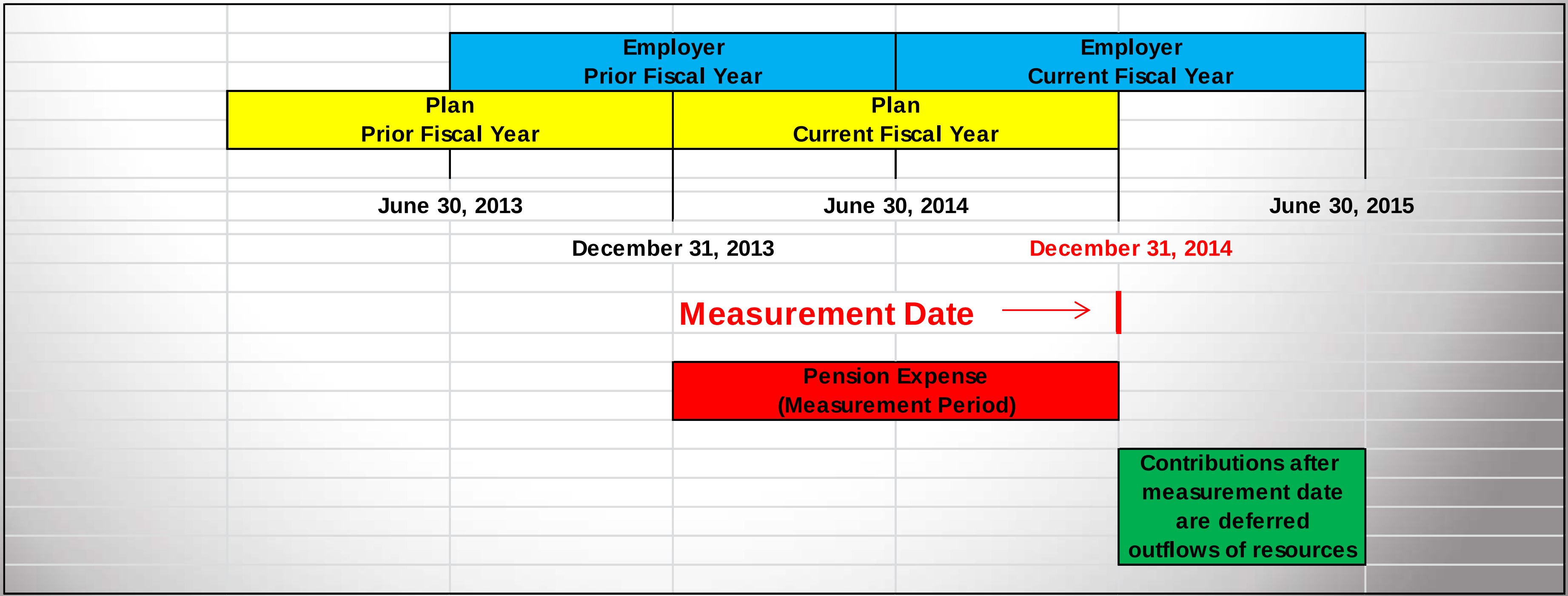
Accounting and Reporting Matters

- The accounting impact of a "Measurement Date" that is six months (December 31 Plans) earlier than the financial reporting date:



Accounting and Reporting Matters

- Based on the tables above, pension expense may be reported for a measurement period that is different than the employer's current fiscal year
  - For government-wide and proprietary funds financial statements, report pension expense for the measurement period and report contributions after the measurement date as deferred outflows of resources
  - Remember – governmental activities report expenses by function on the statement of activities!
- Allocation of pension expense should be based upon the contribution effort among governmental and proprietary funds

Accounting and Reporting Matters

- Restatement of beginning net position for government-wide and proprietary fund financial statements

  - Beginning net pension liability is needed to properly measure the pension expense for the period

Measurement Date	Beginning Net Pension Liability	
June 30, 2015	…	June 30, 2014
December 31, 2014	…	December 31, 2013
June 30, 2014	…	June 30, 2013

  - It may not be practical to determine amounts of all deferred outflows of resources and inflows of resources at the beginning of the period … therefore, in these circumstances these beginning balances should not be restated.

Accounting and Reporting Matters

- Restatement of beginning net position for government-wide and proprietary fund financial statements, continued
  - If multiple periods are presented, should restate the earliest year presented
  - If restatement of all prior periods presented is not practical, the cumulative effect of applying this statement should be reported for the earliest period restated
  - Disclose the nature of the restatement and its effect, including whether the restatement of beginning balances included deferred outflows of resources or deferred inflows of resources

Accounting and Reporting Matters

- Restatement of beginning net position for government-wide and proprietary fund financial statements, continued
  - Allocation of beginning Net Pension Liability among governmental funds and proprietary funds could prove challenging – methodology based on contribution effort
  - Component units that are members of the Primary Government's defined benefit plan should also be allocated its portion of the Net Pension Liability based on its contribution effort

Implementation Issues.

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Accounting and Reporting Matters

- Components of current/deferred costs
  - Immediate current year expenses
  - Deferral of certain outflows of resources and inflows of resources
    - Amortized over a closed period equal to average remaining service lives of all employees (active and inactive), except for projected vs. actual investment earnings, which are amortized over a closed 5 year period
  - Contributions made after the measurement date and before the reporting date are reported as deferred outflows of resources

Implementation Issues.

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Accounting and Reporting Matters

- Considerations for Cost-Sharing Plans
  - Must report a liability, expense, and deferred outflows of resources and inflows of resources equivalent to its proportionate share
  - Recommended basis for "proportionate share" is the employer projected long-term contributions relative to that of all cost-sharing employers' contributions
    - Some Plans are considering using proportionate share of current year contributions as a practical solution
  - Deferrals appropriate for certain changes, such as change in proportionate share
    - *Caution: for County Plans considered substantively a single employer plan with small "cost-sharing" employers*

EXAMPLE OF COST-SHARING PENSION PLAN

Schedule of Employer Allocations

June 30, 2015

Employer/ Nonemployer (special funding situation)	2015 Actual Employer Contributions	Employer Allocation Percentage
State of Example	$ 2,143,842	38.9%
Employer 1	268,425	4.9%
Employer 2	322,142	5.8%
Employer 3	483,255	8.8%
Employer 4	633,125	11.5%
Employer 5	144,288	2.6%
Employer 6	95,365	1.7%
Employer 7	94,238	1.7%
Employer 8	795,365	14.4%
Employer 9	267,468	4.9%
Employer 10	267,128	4.8%
Total	$ 5,514,641	100.0%

Implementation Issues.

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EXAMPLE COST-SHARING PENSION PLAN
Schedule of Pension Amounts
June 30, 2015

		Deferred Outflow of Resources				Deferred Inflows of Resources				Pension Expense	
Employer/ Nonemployer (special funding situation)	Net Pension Liability	Differences Between Expected and Actual Economic Experience	Differences Between Projected and Actual Investment Earnings	Changes of Assumptions	Changes in Employer Proportion and Differences Between Contributions and Proportionate Share of Pension Expense	Differences Between Expected and Actual Economic Experience	Differences Between Actual and Projected Investment Earnings	Changes of Assumptions	Changes in Employer Proportion and Differences Between Contributions and Proportionate Share of Pension Expense	Proportionate Share of Plan Pension Expense	Net Amortization of Deferred Amounts from Changes in Proportion and Proportionate Share of Pension Expense
State of Example	$ 38,589,135	428,768	2,058,088	1,500,690	782,365	380,371	1,063,285	-	584,365	1,878,717	12,375
Employer 1	4,831,647	53,685	257,688	187,898	96,633	47,625	133,131	-	125,325	235,229	(1,793)
Employer 2	5,798,553	64,428	309,256	225,499	115,971	57,156	159,773	-	245,386	282,303	(8,088)
Employer 3	8,698,585	96,651	463,925	338,279	173,972	85,742	239,681	-	125,632	423,492	3,021
Employer 4	11,396,244	126,625	607,800	443,188	227,925	112,332	314,012	-	386,325	554,828	(9,900)
Employer 5	2,597,183	28,858	138,516	101,002	51,944	25,600	71,563	-	42,358	126,444	599
Employer 6	1,716,569	19,073	91,550	66,756	34,331	16,920	47,298	-	24,325	83,571	625
Employer 7	1,696,283	18,818	90,468	65,967	33,926	16,720	46,739	-	125,325	82,584	(5,712)
Employer 8	14,316,562	159,073	763,550	556,756	286,486	141,118	394,478	-	152,005	697,004	8,405
Employer 9	4,814,421	53,494	256,769	187,228	68,325	47,456	132,657	-	87,325	234,391	(1,188)
Employer 10	4,808,301	53,426	256,443	186,990	67,528	47,395	132,488	-	41,035	234,093	1,656
Total	$ 99,263,483	1,102,899	5,294,053	3,860,253	1,939,406	978,435	2,735,105	-	1,939,406	4,832,656	-

Accounting and Reporting Matters

- Considerations for New Disclosures
  - Discount rate … including a determination if the plan assets are sufficient to cover all projected future benefit payments
  - If not sufficient, municipal bond rate and source
  - Asset allocation, including long-term expected rate of return and how derived
  - A sensitivity analysis of +1% and -1%

Accounting and Reporting Matters

- Considerations for New Disclosures, continued
  - A table that reports the changes in total pension liability, plan assets, and net pension liability for the year, by individual components
  - A table that discloses the ending deferred outflows of resources and inflows of resources
  - Also, a schedule that reports the amortization of deferrals for each of the next 5 years and thereafter
  - Layers!!! - The amortization periods are closed, therefore, the amortization will have to be calculated individually for each year and not aggregated

Approach by Employer Auditor

- Defined benefit pension plans
  - Procedures to assess reasonableness of information provided by the Plan
  - Use of management's specialist(s)
  - SSAE-16, Service Organization Control (SOC) report (i.e., processing information)
  - Auditor's reports on supplementary information?

- Additional cost-sharing plan considerations
  - Auditor needs to get comfortable with allocation methodology
  - Will the plan auditor provide separate opinion on supplementary information?

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Thanks for listening.
Questions?